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IN THE

Supreme Court of the United States

October Term, 1944

No. 127

BANKERS TRUST COMPANY, as Trustee, *et al.*,
Petitioners,

against

THE PEOPLE OF THE STATE OF NEW YORK,
Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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Statement

The petitioners pray for a writ of certiorari to review a decree of the Circuit Court of Appeals for the Second Circuit entered on March 3, 1944, which decree in part sustained an order dated June 2, 1943 made by the United States District Court for the Southern District of New York (R. 5).

Pursuant to the opinion of the Circuit Court of Appeals it was determined that the State of New York (hereinafter called the State) had a valid lien against the real property of the New York, Ontario and Western Railway Company,

Debtor (hereinafter called the Debtor) for the amounts due on past due installments of a grade crossing elimination debt (R. 100), and there was reserved for future determination the question of the priority of the State's lien over pre-existing mortgages of the Debtor.

Facts

The petition sets forth only a portion of the facts on which the Circuit Court's determination was based.

I. The Debtor operated a railroad extending from Weehawken, New Jersey to Oswego, New York. The portion of the Debtor's railroad within the State of New York was operated under a franchise from the Legislature of the State of New York (R. 57-58).

II. By authority of a 1925 amendment of the Constitution of the State of New York (Art. VII, Sec. 14) the Legislature adopted what is known as the Grade Crossing Elimination Act (L. 1926, c. 233, superseded by L. 1928, c. 678; McKinney's Unconsolidated Laws, Sec. 7901-12). Pursuant thereto the Debtor, in common with other railroads, was required to eliminate certain grade crossings and to pay fifty percent of the cost of the elimination (Unconsolidated Laws, Sec. 7903).

The Act further provided that if the Railroad so elected the State would pay the Railroad's share of the cost of the elimination in the first instance, and the Railroad would then be obliged to pay the State in a manner to be determined by the State Comptroller, so that the principal and interest on the State's debt, incurred for such elimination, might be paid when due (Unconsolidated Laws, Sec. 7904 (1, 2)).

III. The orders requiring the grade crossing eliminations involved in these claims were made by the Public Service Commission of the State of New York, after public hearings held to determine whether the public welfare required the elimination of each of the crossings (R. 62). Due notice of these hearings was given by service on the Debtor and by publication in a newspaper published in the county wherein the proposed elimination was located (R. 62-64). The Grade Crossing Elimination Act further provided that any person aggrieved by an order of the Public Service Commission could appeal to the Appellate Division of the Supreme Court of the State of New York and to the Court of Appeals (Unconsolidated Laws, Sec. 7910).

IV. The Debtor herein elected in writing to have the State pay its share of the cost of the eliminations in the first instance, and repayment was directed to be made in installments over a period of fifty years (R. 58-59). The Debtor likewise consented in writing to the State Comptroller's determination of the railroad's share of the cost of the elimination. The last of these consents was filed on January 2, 1936 (R. 175), which was prior to the date of the filing of the petition for reorganization on May 20, 1937.

V. No default occurred in the payment of any installment prior to the filing of the Debtor's petition for reorganization. By a petition dated June 22, 1937 the Debtor prayed for permission to continue the payments on said installments as they accrued, and an order was made by the District Court on June 28, 1937 granting such permission (R. 59). Pursuant thereto the Debtor paid all installments due for the year 1937. Beginning in 1938 the Debtor defaulted in the payment of the installments, and continues in default.

The Comptroller of the State of New York duly certified to the Boards of Supervisors of the various counties, wherein the grade crossing eliminations had been carried out, that the Debtor was in default in the payment of the various installments of principal and interest (R. 18-32). Before the Boards of Supervisors could assess and apportion the tax as provided for in the Grade Crossing Elimination Act (Unconsolidated Laws, Sec. 7904 (3)), the petitioners obtained an order from the District Court restraining the Boards of Supervisors from so doing. Thereafter, the District Court lifted the injunction to the extent that leave was granted to the State to assess and apportion its liens. After the assessment and apportionment of the liens by the Boards of Supervisors the proofs of claim were filed herein (R. 80). The claim of August 15, 1941 is for the installments due for the years 1938 and 1939 (which claim the Circuit Court has allowed), and the claim dated March 11, 1942 is for the balance of the principal due on the Debtor's share of the cost of the elimination (which claim the Circuit Court has disallowed upon the ground that there could be no acceleration of the payments unless there was a dissolution of the Debtor, but granted the State leave to assess its lien for all past due installments not included in the claim of August 15, 1941) (R. 102).

The Opinions Below

The case involves two primary questions, of which the first relates to the nature of the lien conferred by New York law. The second, as to the interpretation of the Federal Bankruptcy Act, is important only if it is held that there was no lien under State law at the date the reorganization proceeding began.

On the question of New York Law the District Court, sitting in New York, held that the State obtained a lien at

the latest on the date when it made its advances for the expense of the grade crossing eliminations (R. 85), and it refused to sanction a result which would entitle the purchaser at a foreclosure sale to "take over the railroad with grade crossing eliminations made at the State's expense without any repayment to the State therefor" (R. 86). On the Federal question, it held that section 67b of the Bankruptcy Act (providing that liens for debts owing to a State are valid against a trustee) was not applicable to Chapter VIII of the Bankruptcy Act, which included section 77, governing the reorganization of railroads (R. 78n, 79), but it pointed out that in any event section 77 requires a trustee to take property subject to existing liens (R. 80).

The determination as to the priority of the State's lien was reserved for future consideration (R. 86).

The Circuit Court of Appeals, on appeal by the objectors, again determined the question of State law in favor of the State, with a slight modification. It held that the question "turns upon the intent of the New York Legislature." After analysis of various New York cases, it held that the statute gave the State a lien for the installments as they came due, which would be good against a state receivership or other insolvency proceeding (the modification, from which the State has not appealed, denied the State's right under the New York statute to accelerate future installments for defaults during reorganization).

On the question of recognition of the State lien in a Federal Bankruptcy proceeding, the Circuit Court held that, even if section 67b did not apply, the lien should be given the same recognition in a railroad reorganization that it would have received in receivership. It also pointed out that the State's claim had at least the status of taxes, which it was the duty of the trustee to pay as expenses of administration (28 U. S. C. A. §124a).

ARGUMENT

POINT I

The State of New York has a valid lien against the debtor's real property.

The entire argument in petitioners' brief depends on the validity of Point I of their brief, in which they assert that no lien arose under New York law prior to the commencement of reorganization proceedings.

This question of the interpretation of the New York statute has been decided contrary to petitioners' contentions by a District Judge, resident in New York and sitting in New York, and by a Circuit Court of Appeals sitting in New York. Normally this Court will not review the concurrent determinations of lower Federal Courts on questions of State law.

As this Court said in *MacGregor* v. *State Mutual Life Assur. Co.*, 315 U. S. 280, 281, "We should leave undisturbed the interpretation placed upon purely local law by a Michigan federal judge of long experience and by three circuit judges whose circuit includes Michigan." See also, *Reitz* v. *Mealey*, 314 U. S. 33; *Helvering* v. *Stuart*, 317 U. S. 154.

Upon completion of the grade crossing elimination the Railroad became liable for one-half of the cost thereof (Unconsolidated Laws, Sec. 7903). Upon the Debtor's election to pay in installments the real property of the Debtor became subject to the statutory lien the State had created to secure the moneys due it (Unconsolidated Laws, Sec. 7904 (3)).

The fact that the State is given an immediate lien for amounts advanced in aid of railroad companies was estab-

lished by an opinion of the New York Attorney General shortly after the passage of the 1926 Grade Crossing Elimination Act (1927 Rep. Atty. Gen. 262). The committee report upon which the petitioners rely (Petition, p. 3) for a different construction of the New York statute was not filed until after the bill had become law, and is therefore not decisive of the legislative intent; its bearing upon the nature of the State's lien was undoubtedly considered by the Attorney-General in giving his opinion in 1927. This administrative determination, uniformly followed for over fifteen years, and acted on in other railroad reorganizations, fixed the meaning of the statute, under familiar doctrines of construction.

Martorano v. *Capitol Finance Corporation*, 289 N. Y. 21;

People ex rel. Werner v. *Prendergast*, 206 N. Y. 405, 411;

Matter of City of New York (Willard Parker Hospital), 217 N. Y. 1, 12-13;

1 McKinney's New York Consolidated Laws, §§ 128, 129.

All of the eliminations involved in the proofs of claim herein were completed prior to the petition for reorganization, dated May 20, 1937, so that the Debtor was indebted to the State for the amount allowed by the Court below, prior to the proceedings in the Bankruptcy Court. Such debt was secured by a lien provided for by statute, and the Court took control of the Debtor's property subject to this lien of the State.

In re Missouri Pacific Ry. Co., 113 F. (2d) 794 (C. C. A. 8th).

STATE'S RIGHT TO CREATE A LIEN

The right of the State to create a lien for debts due it stems from the prerogative right at common law, which gave the British Crown a priority over all subjects for payment out of a debtor's property for all debts due it.

Matter of Carnegie Trust Co., 151 App. Div. 606, aff'd, 206 N. Y. 390;
Marshall v. *New York*, 254 U. S. 380;
New York Terminal Co. v. *Gaus*, 204 N. Y. 512.

The lien herein secured a debt due for a governmental purpose, for statutes requiring the elimination of grade crossings are an exercise of the police power of the State.

Matter of Staten Island Rapid Transit R. Co., 220 App. Div. 80, aff'd, 245 N. Y. 643;
Erie Railroad v. *The Board of Public Utilities Comm.*, 254 U. S. 394;
Matter of New York, Ontario & Western Ry. Co., 244 App. Div. 644, aff'd, 271 N. Y. 567;
Denver & Rio Grande R. Co. v. *Denver*, 250 U. S. 241;
Missouri K. & T. R. Co. v. *Oklahoma*, 271 U. S. 303;
Missouri Pacific Ry. Co. v. *Omaha*, 235 U. S. 121.

POINT II

Section 77 of the Bankruptcy Act is intended to recognize the validity of existing liens.

The petitioners herein argue for a narrow construction of Section 77 of the Bankruptcy Act, urging that there having been no default in the payment of the installments prior to the filing of the petition for reorganization, the State is estopped from asserting its lien when there is a

subsequent default by the Debtor in its payments. Such a construction is contrary to the purposes for which Section 77 was enacted. Section 77 has for its main purpose the rehabilitation, and to that extent contemplates the corporate existence, of the Debtor.

Thompson v. *Louisiana*, 98 F. (2d) 108, 110 (C. C. A. 8th).

Van Schaick v. *McCarthy*, 116 F. (2d) 987, 993 (C. C. A. 10th).

The Act of June 2, 1934 (C. 585, 58 Stat. 993, 28 U. S. C. A. Sec. 124 a) imposed a duty on the Trustee of the Debtor to pay the installments as they became due,

Palmer v. *Webster Atlas National Bank*, 312 U. S. 156;

In Re Fonda, Johnstown & Gloversville Ry. Co., 126 F. (2d) 604; cert. den. *sub. nom. Zimmer* v. *New York State Tax Comm.*, 316 U. S. 701;

and upon the failure of the Trustee so to pay, the State was entitled to assess its lien.

The power of the Court to permit the assessment and apportionment of the lien was derived from subdivision (b) of Section 77 as well as from Section 67b of the Bankruptcy Act.

Subdivision (b) of Section 77 provides that the term "creditors" shall include all holders of claims, whether or not such claims would constitute provable claims under the Act, and "claims" is defined as including liens. The courts have interpreted this provision to permit the filing of claims that would necessarily have been barred under the strict interpretation of the Act urged by the petitioner.

In re Chicago, Milwaukee, St. P. & P. Ry. Co., 27 F. Supp. 685 (N. D. Ill.);

New York Trust Co. v. *Palmer*, 101 F. (2d) 1 (C. C. A. 2d);
Lyford v. *City of New York*, 137 F. (2d) 782 (C. C. A. 2d);
Thompson v. *Glover*, 94 F. (2d) 544 (C. C. A. 8th);
Boteler v. *Ingels*, 308 U. S. 57;
City of New York v. *Rassner*, 127 F. (2d) 703 (C. C. A. 2d).

In addition to the broad powers conferred on the Court by subdivision (b) of Section 77, Section 67-b of the Bankruptcy Act specifically permits the State to perfect its lien despite the fact the mechanics of the assessing and apportioning the lien had not been completed prior to the filing of the petition for reorganization.

As the New York statute was construed below, the debt having been incurred by the Railroad prior to the filing of the petition, its payment was at all times secured by a lien on the real property of the Debtor. Upon default in payment all that remained for the State to do was to assess and apportion its lien (Unconsolidated Laws, Sec. 7904 (3)).

The very purpose of the enactment of Section 67-b of the Bankruptcy Act was to protect the United States Government and the various States in the exact situation presented herein. While it is true that Section 77 is not referred to specifically in Section 67-b of the Bankruptcy Act, nevertheless the provisions of the Bankruptcy Act should be applied to a proceeding under Section 77 unless the provisions of the Bankruptcy Act are inconsistent with the provisions of Section 77.

Lyford v. *City of New York*, *supra*;
New York Trust Co. v. *Palmer*, *supra*;

Board of Directors, St. Francis Levee District v. *Kurn*, 98 F. (2d) 394 (C. C. A. 8th), cert. den., 305 U. S. 647;
Thompson v. *Glover, supra;*
In re. Erie R. Co., 37 F. Supp. 237 (N. D. Ohio).

POINT III

The Circuit Court of Appeals was correct in its holding that the claims are payable as taxes.

There is no basis for petitioners' assertion that the decision of the Circuit Court of Appeals herein was contrary to the law of New York as announced in the case of *Central Savings Bank* v. *City of New York*, 279 N. Y. 266. The charge imposed under the statute therein was held not to be a tax solely because it was optional with the owner whether he accepted it or not (p. 280).

In the instant appeal the assessment for the Railroad's share of the cost of the elimination meets all the requirements of a tax as defined by the Court of Appeals in the *Central Savings Bank* case:

> "A tax is a forced charge levied by the State upon persons or property. It operates *in invitum* and is in no way dependent upon the will or contract, expressed or implied, of the persons taxed. (City of Rochester v. Bloss, 183 N. Y. 42, 47, 48; City of New York v. McLean, 170 N. Y. 374)". (p. 280.)

The acceptance of the charge for the cost of the grade crossing elimination involved in this appeal was in no way optional with the Debtor. One-half of the cost of the elimination was imposed on the Railroad irrespective of the desires of the Railroad (Unconsolidated Laws, Sec. 7903).

Matter of New York, Ontario & Western R. Co., 244 App. Div. 664, aff'd, 271 N. Y. 567.

The only option afforded the Railroad under the statute was the privilege of paying its share in installments, if it so desired. This privilege in no way altered its nature as a forced charge levied by the State, for the Railroad was at all times obligated to pay one-half of the cost, irrespective of which manner of payment it elected to use.

The Grade Crossing Elimination Act further provided that in the event of a default it became the duty of the towns and cities to collect the moneys in the same manner as other taxes are collected in such towns and cities (Unconsolidated Laws, Sec. 7904 (3)).

The constitutional objections in the *Central Savings Bank* case were based on the failure to afford a proper hearing to property owners, and the use of the money collected for a private purpose; neither factor is present in this case.

Under the Grade Crossing Elimination Act the Public Service Commission could order a crossing eliminated only after a public hearing on due notice to all interested parties, and subject to review by the Appellate Division and the Court of Appeals (Unconsolidated Laws, Sec. 7902 (5), 7910).

The Debtor did appeal from the order of the Public Service Commission for one of the eliminations involved in this claim, and the Court of Appeals upheld the constitutionality of the statute *(Matter of New York, Ontario and Western R. Co., supra)*.

As to the purpose for which the moneys were to be used, one of the cases relied upon by the Court of Appeals

in the *Central Savings Bank* case was the decision of this Court in

> *Panhandle Eastern Pipe Line Co.* v. *State Highway Comm.*, 294 U. S. 613.

This latter case emphasized the fact that grade crossing elimination statutes are one of the highest possible uses of the police power for a public purpose (294 U. S. at 620-22).

POINT IV

A governmental preference is involved.

Irrespective of whether the moneys due from the Debtor to the State are labeled a tax or simply a debt, the State is still entitled to its governmental preference. The Courts have held that senior position should be given to any charge which is imposed by a State in connection with a public improvement necessitated by the exercise of the police power of the State.

> *In re Mid America Co.*, 31 F. Supp. 601, 603 (S. D. Ill.);
>
> *In re Otto F. Lange Co.*, 159 Fed. 586 (N. D. Iowa).

CONCLUSION

We respectfully submit that this cause presents no question warranting review by this Court, and urge that the petition be denied.

Dated: July 6, 1944.

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